



**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

**FILED**

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**A2303001**

In the Matter of the Application of Crimson California Pipeline L.P. (PLC-26) for Authority to Increase Rates for Its Crude Oil Pipeline Services. (NORTHERN CALIFORNIA)

Application No.

**APPLICATION**

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Date: March 3, 2023

Attorneys for Crimson California Pipeline,  
L.P.

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Crimson California Pipeline L.P. (PLC-26) for Authority to Increase Rates for Its Crude Oil Pipeline Services. (NORTHERN CALIFORNIA)

Application No.

**APPLICATION**

Pursuant to Section 454 of the California Public Utilities Code<sup>1</sup> and in accordance with Rules 2.1, 2.2, 3.2, and 7 of the Commission’s Rules of Practice and Procedure, Crimson California Pipeline, L.P. (“Crimson” or “Applicant”) respectfully requests that the California Public Utilities Commission (“Commission”) authorize Crimson to increase the rates that it charges for transportation of crude petroleum products on its KLM Pipeline System (“KLM”) by 107.2%, effective upon approval by the Commission. Crimson is seeking the subject rate increase in order to recover its Commission-jurisdictional cost of service given current rates and throughput levels and in order to have the opportunity to earn a reasonable return on its utility investment.<sup>2</sup>

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<sup>1</sup> All statutory references are to the California Public Utilities Code unless otherwise noted.

<sup>2</sup> On July 29, 2022, Crimson filed Application No. 22-07-015 implementing an increase of 10% to the transportation rates that apply to movements on KLM effective September 1, 2022. A.22-07-015 remains pending before the Commission. The subject application seeks authorization to increase the transportation rates at issue in A.22-07-015 by a further 107.2%. It is Crimson’s intent to file a motion to consolidate seeking consolidation of the A.22-07-015 application with the subject Application.

**I. Background**

**1. Applicant Information Required by Rule 2.1(a)**

Applicant Crimson is a California limited partnership. Its principal place of business is 3760 Kilroy Airport Way, Suite 300, Long Beach, California, 90806; its telephone number is (562) 285-4100. Its general partner is Crimson Pipeline, LLC, which is wholly owned by Crimson Midstream Operating, LLC. Crimson Midstream Operating, LLC is wholly owned by Crimson Midstream Holdings, LLC. Crimson Midstream Holdings, LLC is controlled by an individual.<sup>3</sup>

**2. Correspondence and Communication Information Required by Rule 2.1(b)**

Correspondence and communications concerning this Application should be directed to the following Crimson representatives:

Caldwell Boudreaux Lefler PLLC  
Charles F. Caldwell  
Deborah R. Repman  
1800 West Loop South, Suite 1680  
Houston, Texas 77027  
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Email: [msomogyi@downeybrand.com](mailto:msomogyi@downeybrand.com)

**3. Organization and Qualification to Transact Business Documents Required by Rule 2.2**

Per Rule 2.2 of the Commission's Rules of Practice and Procedure, Crimson incorporates by reference its Certificate of Limited Partnership filed as Exhibit A of Application 04-06-002 on June 1, 2004. Crimson's Certificate of Limited Partnership is included as Exhibit A hereto.

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<sup>3</sup> See D.22-1-032; mimeo. at p. 7.

**4. Information Required by Rule 3.2**

**A. Balance Sheet and Income Statement:**

Financial statements, including the most recently available balance sheet and income statement for Crimson, are attached as Exhibit B hereto.

**B. Statement of Presently Effective and Proposed Rates:**

Present and proposed rates for KLM are reflected in Exhibit C. Exhibit C sets forth the following regarding each transportation movement on KLM: (1) the currently effective rate; and (2) the rate reflecting the 107.2% rate increase that is the subject of this Application.

**C. General Description of Crimson's Property and Equipment:**

Applicant Crimson has been formed as a limited partnership for the specific purpose of owning, operating, and managing smaller, marginal, or idle pipelines and providing pipeline transportation services to the public.

KLM consists of approximately 295 miles of pipe running from points in the San Joaquin Valley production areas to San Francisco Bay Area refinery connections.

**II. Justification for Requested Rate Increase**

Exhibit D hereto, the Declaration of Michael J. Webb, sets forth the basis, as well as justification, for Crimson's request pursuant to Section 454 to increase the KLM rates by 107.2%. As demonstrated in Exhibit D, the proposed rate increase is necessary to allow Crimson the opportunity to recover the reasonable costs of operating KLM and earn a reasonable return on its utility investment.

**III. Information Required for Rule 2.1(c) and Rule 7 Compliance**

The subject Application seeks authorization, pursuant to Section 454 of the Public Utilities Code, for Crimson to increase the rates it currently charges for intrastate public utility

pipeline services on KLM by 107.2%.

Crimson has provided all shippers affected by the proposed rate increase with copies of this Application.

**A. Proposed Category:** Crimson proposes that the Application be treated as a “ratesetting” proceeding.

**B. Need for Hearing:** Hearings will be needed on this Application only to the extent a material issue of fact is raised by timely protest. Accordingly, Crimson does not know whether a hearing will be required. If no hearing is required, Crimson would request that an ex parte decision approving the rate increase request be issued by the Commission by December, 2023. If a hearing is required, Crimson proposes a schedule as set forth below.

**C. Issues Requiring Consideration:** The sole issue raised by this Application is whether Crimson’s proposal to increase its KLM rates by 107.2% is just and reasonable.

**D. Proposed Schedule:** Crimson proposes the following schedule:

Application Filed	March 3, 2023
Notice in Daily Calendar	TBD by CPUC Docket Office
Protests Due	30 Days After Daily Calendar Notice
Applicant’s Opening Testimony	March 17, 2023 <sup>4</sup>
Intervenor Testimony Due	May 19, 2023
Applicant’s Rebuttal Testimony	June 16, 2023
Hearings	TBD
Concurrent Opening Briefs	TBD
Concurrent Reply Briefs	TBD

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<sup>4</sup> As previously indicated, Crimson intends to file a motion requesting consolidation of the pending A.22-07-015 application with the subject Application. In anticipation of consolidation of the two proceedings, Crimson’s proposed schedule for the subject application corresponds with the procedural schedule set forth in the Scoping Memo issued November 1, 2022 in A.22-07-015.

ALJ Draft Decision  
Commission Decision

TBD  
TBD

#### **IV. Exhibits**

As required by Commission Rules 15, 16, and 23, Crimson provides the following information and exhibits:

Exhibit A	Crimson Certificate of Limited Partnership
Exhibit B	Crimson Financial Statements
Exhibit C	Current and Proposed Rates
Exhibit D	Declaration in Support of Rate Increase

**WHEREFORE**, Crimson requests:

1. That the Commission issue an opinion and order approving the requested increase in Crimson's KLM tariff rates as quickly as is practicable; and
2. That the Commission grant such other and further relief as shall be just and proper. Crimson is prepared to review the analysis and forecasts supporting this filing with Staff upon request.

Respectfully submitted this 3rd day of March, 2023 at San Francisco, California.

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By: /s/ Charles F. Caldwell  
Charles F. Caldwell

By: /s/ James D. Squeri  
James D. Squeri

Attorneys for Crimson California Pipeline, L.P

**VERIFICATION OF COUNSEL**

I, James D. Squeri, declare:

I am an attorney at law duly admitted and licensed to practice before all courts of this state and I have my professional office at Downey Brand LLP, 455 Market Street, Suite 1500, San Francisco, California 94105.

I am an attorney for Applicant, Crimson California Pipeline L.P., in the above-entitled matter.

No officer of Crimson California Pipeline, L.P. is present in the county in which I have my office and for that reason I am making this verification on behalf of Crimson California Pipeline L.P.

I have read the foregoing Application and know its contents thereof.

I am informed and believe that the matters stated therein are true and, on that ground, I allege that the matters stated therein are true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at San Francisco, California on this 3rd day of March, 2023.

/s/ James D. Squeri  
James D. Squeri



EXHIBIT A

CRIMSON CERTIFICATE OF GOOD STANDING



# Secretary of State Certificate of Status

I, SHIRLEY N. WEBER, PH.D., California Secretary of State, hereby certify:

<b>Entity Name:</b>	CRIMSON CALIFORNIA PIPELINE, L.P.
<b>Entity No.:</b>	200405400002
<b>Registration Date:</b>	02/20/2004
<b>Entity Type:</b>	Limited Partnership - CA
<b>Formed In:</b>	CALIFORNIA
<b>Status:</b>	Active

The above referenced entity is active on the Secretary of State's records and is authorized to exercise all its powers, rights and privileges in California.

This certificate relates to the status of the entity on the Secretary of State's records as of the date of this certificate and does not reflect documents that are pending review or other events that may impact status.

No information is available from this office regarding the financial condition, status of licenses, if any, business activities or practices of the entity.



**IN WITNESS WHEREOF**, I execute this certificate and affix the Great Seal of the State of California this day of February 24, 2023.

**SHIRLEY N. WEBER, PH.D.**  
Secretary of State

**Certificate No.:** 085264131

To verify the issuance of this Certificate, use the Certificate No. above with the Secretary of State Certification Verification Search available at [bizfileOnline.sos.ca.gov](http://bizfileOnline.sos.ca.gov).

## EXHIBIT B

### CRIMSON FINANCIAL STATEMENTS

Consolidated CorEnergy  
Summary of All Units  
For the Twelve Months Ending Saturday, December 31, 2022

	204
	<u>Crimson California</u>
	<u>KLM</u>
<b>ASSETS</b>	
Current Assets	
Cash	(117,161)
Accounts Receivable - Trade	1,159,633
Prepaid expenses and other Assets	<u>285,993</u>
Total Current Assets	1,328,465
Fixed Assets	
Property and Equipment	5,354,813
Property and Equipment (Accum. Dep.)	<u>(89,433)</u>
Total Fixed Assets	5,265,380
Other Assets	
Intercompany Receivables	<u>55,440</u>
Total Other Assets	<u>55,440</u>
<b>TOTAL ASSETS</b>	<b><u><u>6,649,285</u></u></b>
<b>LIABILITIES &amp; EQUITY</b>	
Liabilities	
AP and other accrued liabilities	<u>(916,195)</u>
Total Accounts Payable	(916,195)
Long-Term Liabilities	
Intercompany Payables	<u>(94,378)</u>
Total Long-Term Liabilities	<u>(94,378)</u>
Total Liabilities	(1,010,573)
Equity	
Additional Paid-in Capital	(21,488,318)
Accumulated Retained Earnings	16,736,731
Net Income (Loss)	<u>(887,125)</u>
Total Equity	<u>(5,638,712)</u>
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b><u><u>(6,649,285)</u></u></b>

*Difference*

Consolidated CorEnergy  
Summary of All Units  
For the Twelve Months Ending Saturday, December 31, 2022

	<u>204</u>
	<u>Crimson California</u>
	<u>KLM</u>
<b>Revenue</b>	
Transportation	9,835,087
<b>Total Revenue</b>	<b>9,835,087</b>
<b>Expenses</b>	
<b>Operating Expenses</b>	
Salaries & Benefits Opex	2,483,138
Materials and Supplies	49,360
Field Office	16,931
Asset Maintenance	2,443,424
Outside Services	335,439
Utilities and Power	361,386
Right of Way	43,541
Regulatory, Environmental, and Safety	435,741
Insurance and Bonds	647,975
Taxes	449,030
Other Expenses	149,864
<b>Total Operating Expenses</b>	<b>7,415,829</b>
<b>SG&amp;A Expenses</b>	
Salaries & Benefits - G&A	817,710
Professional Services	392,546
Director's Fees	23,198
Other expenses - G&A	189,048
<b>Total SG&amp;A Expenses</b>	<b>1,422,503</b>
<b>Total Expenses</b>	<b>8,838,332</b>
<b>Net Ordinary Income</b>	<b>996,755</b>
<b>Other Income/Expense</b>	
Depreciation Expense	109,630
<b>Total Other Income/Expense</b>	<b>109,630</b>
<b>Net Income</b>	<b>887,125</b>

## EXHIBIT C

### CURRENT AND PROPOSED RATES

## Crimson California Pipeline L.P. - KLM

107.2% increase; rates in cents per barrel

Current Tariff	P/L - Route	A. 22-07-015		
		Current Rae, cpb	Proposed Rate, cpb	Increase, %
Cal. PUC 204.4	Buena Vista Area (Kern County) - Bay Area Refineries	194.81	403.65	107.2%
Cal. PUC 204.4	Signa Station - Bay Area Refineries	194.81	403.65	107.2%
Cal. PUC 204.4	Midway Station - Bay Area Refineries	182.95	379.08	107.2%
Cal. PUC 204.4	Derby Acres - Bay Area Refineries	176.79	366.31	107.2%
Cal. PUC 204.4	Cymric Area - Bay Area Refineries	170.82	353.94	107.2%
Cal. PUC 204.4	Belridge Station - Bay Area Refineries	158.53	328.48	107.2%
Cal. PUC 204.4	Lost Hills/Cahn - Bay Area Refineries	146.42	303.38	107.2%

EXHIBIT D

DECLARATION IN SUPPORTED OF REQUESTED RATE INCREASE



## **Declaration of Michael J. Webb**

### **I. Introduction and Statement of Qualification**

1. My name is Michael J. Webb. I am Vice President of Regulatory Economics Group, LLC (“REG”), a consulting firm with offices in Reston, Virginia and San Francisco, California. My business address is 11180 Sunrise Valley Drive, Reston, Virginia 20191. I hold a PhD and MA in Economics from George Mason University and a BA in Economics from American University. I have 25 years of experience in the oil pipeline industry. I have provided testimony before the California Public Utilities Commission (“CPUC” or “Commission”), the Federal Energy Regulatory Commission (“FERC”), the National Energy Board (Canada), the Canadian Energy Regulator, the Kansas Corporation Commission, the Regulatory Commission of Alaska, the Wyoming Public Service Commission, the Virginia State Corporation Commission, the Railroad Commission of Texas, the American Arbitration Association, the Pennsylvania Public Utilities Commission, the Louisiana Public Utilities Commission, the Court of Chancery of the State of Delaware, and the District Court for the 269<sup>th</sup> District of Texas. In these forums, my testimony has addressed a variety of issues relating to oil pipeline regulation.
2. I have been asked by Crimson California Pipeline, L.P. (“Crimson”) to calculate a Cost of Service and Achieved Return figures for Crimson’s KLM pipeline system, which transports crude oil from the San Joaquin Valley production area to the Bay Area (“KLM System”). The purpose of my analyses and related calculations is to demonstrate that the requested rate increase of 107.2 percent that is the subject of the instant application (“Application”) is reasonable. I note that on July 29, 2022, Crimson filed Application No. A.22-07-015 seeking authorization to increase the transportation rates applicable to

movements on the KLM System by 10 percent effective September 1, 2022. By this Application, Crimson is seeking a further increase of 107.2 percent, resulting in an aggregate rate increase of 127.9 percent.

3. An Achieved Return figure provides a way to calculate the return that a public utility, such as Crimson, will earn at a given rate level. Similarly, a Cost-of-Service calculation demonstrates the imbalance between operating expenses and rate base elements. In Section II of this declaration, I present a summary of the elements used to calculate the Achieved Return and Cost of Service for the KLM System. I then present a Cost of Service (contained in Exhibit No. MJW-2) and two Achieved Return figures (contained in Exhibit No. MJW-1). The first Achieved Return figure shows the return Crimson would realize based on the current KLM System rates, which includes the 10 percent increase that is the subject of A.22-07-015. The second Achieved Return figure shows the return Crimson would realize if the current KLM System rates were increased by 107.2 percent. In Section III of this declaration, I present a calculation of the cost of capital. Comparing the cost of capital to the Achieved Return figures demonstrate that Crimson's request to increase the KLM System rates by 107.2 percent is just and reasonable.
4. To complete the analyses described in this declaration, I have relied on cost data and information provided to me by Crimson concerning the KLM System .

## **II. Cost of Service and Achieved Return Calculation**

5. An Achieved Return calculation (as shown in Exhibit No. MJW-1) begins with the revenue generated by a given set of rates, subtracts from that revenue amount the costs of providing service, and then divides the residual by the cost of the assets used to provide service. The figure, expressed as a percentage, is compared against various capital market metrics for

comparable companies to determine if the Achieved Return is in the zone of reasonableness, presuming one is setting a cost-based rate.<sup>1</sup> To the extent the Achieved Return figure with current rates is significantly below the capital market metrics, it is appropriate to allow the utility to raise its rates to a level that will generate an Achieved Return aligned with these market metrics.

6. In preparing my Achieved Return calculations, I have relied upon a few basic principles. First, I began with actual data from the books and records of the company for calendar year 2022 (*i.e.*, January 2022 to December 2022) (such period referred to herein as the “Base Period”). Next, to the extent there was evidence that a particular cost incurred during the Base Period was not representative of a recurring cost amount and/or a particular Base Period cost is expected to change (*e.g.*, increase or decrease) with known and measurable accuracy during the Test Period (*i.e.*, January 2023 to December 2023), I made an appropriate adjustment. In addition, it is my understanding that the Commission, like most regulatory agencies, bases such Achieved Return and Cost-of-Service calculations on original cost data. Consequently, as I discuss in subsection b. below, I have obtained the original cost figures from Crimson for the KLM System. In the subsections below, I discuss the various cost elements of the Achieved Return calculation. I then discuss the calculation of revenue from which these costs should be subtracted and measured against, as well as summarizing my a Cost-of-Service calculation (Exhibit No. MJW-2).

- a. Operating Expenses

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<sup>1</sup> Section III will discuss in detail the process of balancing investors’ interests in ensuring the financial integrity of the enterprise with consumers’ interest in not paying excessive rates, as first described in the seminal U.S. Supreme Court decision *Federal Power Comm’n v. Hope Natural Gas*, 320 US 591 (1944) (“*Hope*”).

7. I began my calculation of operating expenses by obtaining actual operating expense data for the KLM System for the Base Period, which are categorized in the Uniform System of Accounts for oil pipelines that I understand to be the convention relied on by the Commission. As shown on Line 20 of Exhibit No. MJW-2, Statement B, Crimson incurred approximately \$11.6 million of operating expenses during the Base Period related to the KLM System. I worked with Crimson personnel to identify any nonrecurring expenses that were incurred during the Base Period, as well as any known and measurable changes to operating expenses that were projected for the Test Period. Any Test Period adjustments I made are shown in Exhibit No. MJW-2, Statement B, and represent adjustments that Crimson believes will occur with known and measurable accuracy during the Test Period.
8. I made the following two Base Period operating expense adjustments:
- A \$2,003,599 increase to Account 330, Operating Fuel and Power, to account for the approximately 18 percent of the barrel-miles on the San Pablo Bay ("SBP") system, which is not the subject of this Application, that is attributed to movements on the KLM System. Upon reaching the end of the KLM System, barrels continue (via the SBP system) in a northward direction, to the same Bay Area refineries. These barrels, however, are subject to the KLM tariff. Attributing the fuel and power costs associated with movements by KLM System shippers in the Achieved Return and Cost-of-Service calculations for the KLM System ensures that shippers on the SPB system are not paying costs for which they do not benefit.
  - A \$1.2 million decrease to Account 320, Outside Services, which recognizes that the amount of tank cleaning costs Crimson incurred for the KLM System during the Base Period was not an expected recurring cost amount.

9. Incorporating the above two Base Period adjustments implies a Base Period operating expense amount of approximately \$12.4 million.
10. Next, I identified twelve Test Period adjustments to account for known and measurable changes. Those adjustments include:
- A \$599,239 decrease to Account 300, Salaries and Wages, a \$232 increase to Account 500, Salary and Wages, and a \$84,747 decrease to Account 550 Employee Benefits, to account for lower headcount and allocations to other entities;
  - A \$6,193 decrease in Account 310, Materials and Supplies, and a \$5,718 increase in Account 510, Materials and Supplies, to account for changes in field office-related supply costs;
  - A \$400,000 increase to Account 320, Outside Services, to amortize future tank cleaning projects;
  - A \$106,083 increase in Account 320, Outside Services, and a \$22,174 increase in Account 520, Outside Services, to account for increased regulatory costs from the California Fire Marshal;
  - A \$750,000 increase in Account 520, Outside Services, to account for rate filing and litigating a tariff increase;
  - A \$44,213 increase in Account 330, Operating Fuel and Power, to account for increased electricity costs due to rising natural gas prices;
  - A \$2,012 increase in Account 350, Rentals, and a \$22,135 decrease in Account 530, Rentals, to account for decreases in lease expenses;
  - A \$677,273 increase in Account 540, Depreciation and Amortization, to account for approximately \$1.3 million in property additions and decreasing the expected

economic life of the KLM System to match the expected life of the SPB system, upon which the KLM System currently depends to effectuate movements;

- A \$59,866 increase in Account 560, Insurance, to account for higher insurance costs;
- A \$55,466 decrease in Account 580, Pipeline Taxes, to account for lower employee taxes; and
- A \$49,647 decrease in Account 390, Other Expenses, and a \$32,644 decrease in Account 590, Other Expenses, to account for decreased vehicle-related costs.

11. As the above illustrates, I have made both upward and downward Test Period adjustments to Crimson's operating expenses for the KLM System to ensure that the most representative expenses are included in the Cost of Service and accounted for in the Achieved Return calculations. These Test Period adjustments, combined with the Base Period adjustments described above, yield a Test Period operating expense amount of approximately \$14.2 million.

b. Calculation of Original Cost Rate Base

12. Rate Base enters the Achieved Return calculation in two ways. First, the depreciation of Rate Base (*i.e.*, recovering the economic cost of investing in assets over the expected life of the assets) is a cost that must be subtracted from revenue. Second, dividing the residual revenue (after subtraction of operating expenses, depreciation, and other costs) by Rate Base generates the Achieved Return.
13. It is my understanding that this Commission employs the depreciated original cost approach ("DOC") for calculating Rate Base. The original cost of the assets calculated under the DOC approach is typically defined as the cost to the first entity to place an asset in public service. I began with the 1983 Rate Base of approximately \$4.4 million and relied

on additions and retirements contained in the company's books and records (Exhibit MJW-2, Statement E).

c. Depreciation

14. In addition to earning a return on its Rate Base, Crimson must recover the costs of the KLM System assets in Rate Base over the remaining service life during which these assets are expected to be in operation. I used a composite depreciation rate of 3.52 percent (Exhibit MJW-2, Workpaper 2). The expected life of the KLM System matches that of the SPB system, upon which the KLM System currently depends to effectuate movements.

d. Income Taxes

15. Because Crimson (the owner/operator of the KLM System) is not itself a tax paying entity and consistent with precedent at this Commission, I have not included an Income Tax Allowance or any related items (*e.g.*, ADIT) in the Cost-of-Service calculation.

e. Volume and Revenue

16. Having identified each of the cost elements comprising the Achieved Return calculation, it is necessary to calculate the revenue that Crimson will earn for providing transportation service on the KLM System. Crimson has advised me that its revenue for the KLM System comes from a single source: collecting tariff rates filed with the Commission for transportation of oil. Therefore, estimating Test Period revenue will be a function of projected volumes and projected transportation rates.
17. To estimate the projected Test Period volume level, I began with the actual long-haul volumes that were transported on the KLM System during the Base Period of 8,710,091 barrels (*see* Exhibit No. MJW-2, Workpaper 3, Line 10). Crimson informed me of its projected volumes for the Test Period. I have applied these changes to the Base Period

volume, which results in a Test Period volume of approximately 7,721,060 barrels, as shown on Line 10 of Exhibit No. MJW-2, Workpaper 3.<sup>2</sup>

f. Achieved Return

18. Exhibit No. MJW-1, Line 14, Column [a] shows the Achieved Return assuming revenues based upon Crimson's current rates for movements on the KLM System. Under this scenario, Crimson would earn an Achieved Return on Equity of approximately negative 24.72 percent on the KLM System. In other words, Crimson would provide transportation service on the KLM System at an economic loss.
19. Exhibit No. MJW-1, Line 14, Column [b] shows the Achieved Return Crimson would earn if it raised the KLM System rates by the requested 107.2 percent. Under this scenario, Crimson would earn an Achieved Return on Equity of approximately 11.45 percent.

### **III. Cost of Capital**

a. Cost-of-Capital Principles

20. *Hope* constitutes one of the seminal U.S. Supreme Court cases setting forth fundamental principles to set just and reasonable cost-based rates for a regulated utility. In relevant part, *Hope* teaches that a rate falls within the zone of reasonableness if it balances the interests of the investor and the consumer. The U.S. Supreme Court states in *Hope* that:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for capital costs of the business... By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.

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<sup>2</sup> I note that Crimson did not increase the rate applicable to movements on the WSJ line segment of the KLM System pursuant to the application filed in A.22-07-015; Crimson is also not seeking to increase such rate as part of the instant Application. To eliminate controversy, however, I made the decision to use the higher, previously requested rate for the WSJ line segment for purposes of calculating the Achieved Return presented in this declaration. This results in slightly lower maximum rates.



From this quote, it should be immediately apparent that the Crimson's current rates for the KLM System fall well outside of the zone of reasonableness and result in an Achieved Return on Equity of approximately negative 27.8 percent. In other words, the current rates do not even produce enough revenue to cover the KLM System's operating expenses, much less an Achieved Return sufficient to attract capital. In the Base Period, Crimson experienced a revenue deficiency of 127.9 percent for the KLM System (*see* Exhibit No. MJW-2, Statement A, Line 10).

21. *Hope* also teaches that in assessing whether a given rate (or rate increase) achieves the appropriate balance, one must compare the return generated by the regulated rates to the return generated by other firms of similar risk. Typically, this means comparing the Achieved Return on Equity to the return of other publicly traded oil pipeline companies.
22. Calculating the appropriate cost of capital for a regulated utility like Crimson involves three key variables: capital structure (*i.e.*, the ratio of equity to long-term debt), cost of debt ("COD"), and return on equity ("ROE"). The combination of these three figures produces a weighted average cost of capital ("WACC").<sup>3</sup> Applying the WACC to the Rate Base produces the total return that the utility requires to provide service.

b. Capital Structure and COD

23. In important ways, Crimson differs from other public utilities regulated by this Commission. Specifically, Crimson does not issue long-term debt but relies on its owners as well as variable rate credit facility for financing. Because these credit facilities differ in fundamental ways from long-term debt, it is inappropriate to incorporate them into the cost-

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<sup>3</sup>  $WACC = (COD * \% Debt) + ROE * (1 - \% Debt)$

of-capital calculation. Consequently, one could argue that the WACC and the ROE should be equivalent. However, shippers may argue that such an approach generates an excessive return, and the Commission may have concerns that such a precedent would provide an incentive for other utilities to reduce their reliance on debt, even if the incurrence of debt is economically efficient. Therefore, I have calculated Crimson's Achieved Return for the KLM System as if it had 40 percent long-term debt (*i.e.*, a capital structure of 40 percent debt, 60 percent equity). While several of the major publicly traded oil pipeline companies have higher debt percentages, in my opinion it is appropriate to use a lower debt percentage for Crimson here to account for its smaller size and the KLM System's reliance on a small number of producers with declining production and the associated higher level of risk. Not only is this 60/40 equity structure economically sensible, it is consistent with Commission precedent. For example, in Decision 20-11-026 Crimson received approval to increase its rates for transportation on its Southern California system. Those rates were based on a cost of capital that included a capital structure of 60 percent equity, 40 percent debt. In fact, I have employed the same structure and principles to calculate the cost of capital in this proceeding that were accepted by the Commission in Decision 20-11-026.

24. In addition to capital structure, it is necessary to estimate Crimson's COD. The company informs that it believes its debt would be rated no better than single B level. Over the 6-month period ending December 1, 2022, single B bonds have traded with an average yield of 8.80 percent. I would also note that in the past few months, unusual economic fluctuations caused by increases in the Federal Funds Rate have caused yields to rise dramatically. Therefore, I believe my use of a debt cost of 8.80 percent for determining

CAPM value with the previously calculated DCF value results in a nominal composite average ROE of 12.64 percent.

36. Because Crimson is significantly smaller and faces significantly higher risk than that of the large and diversified companies included in the proxy group, I have added 100 basis points to the nominal composite average ROE based on the DCF model and CAPM to develop a risk adjusted ROE of 13.64 percent.

#### **IV. Conclusion**

37. As shown in the Exhibit No. MJW-1, under its current rates Crimson will earn an overall Return on Rate Base of negative 11.31 percent in the Test Period for the KLM System; its Achieved Return on Equity will be negative 24.72 percent. In other words, Crimson's expenses and debt costs will exceed the revenue it receives for providing transportation service on the KLM System. Raising rates by 107.2 percent will allow Crimson to earn an overall Achieved Return on Rate Base of 10.39 percent and an Achieved Rate of Return on Equity of 11.45 percent on the KLM System, both of which are a reasonable return on equity.

The foregoing declaration is submitted under penalty of perjury in accordance with the laws of the State of California.

Dated: March 3, 2023

/s/ Michael J. Webb

Michael J. Webb